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# Total Environment Centre

# Submission to the AEMC Strategic Priorities for Energy Market Development

## Discussion Paper

## May 2011

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**Introduction**

The Strategic Priorities for Energy Market Development market review marks the beginning of a change in the perception of the National Energy Market by the AEMC. The paper recognises rising peak demand and retail prices as key emerging challenges for energy market design. It highlights a relationship between the NEM and wider government policy on climate change and energy. It states that demand-side participation can improve environmental and economic outcomes in the NEM. Finally, it signals the beginning of a new wave of reform in the NEM, transforming from a market for electricity and gas as commodities to one that supplies energy services for the long-term interests of energy consumers. Total Environment Centre is pleased with these positive developments and looks forward to advising the AEMC throughout this market review process.

The purpose of Total Environment Centre's National Energy Market campaign is to deliver better social, environmental and economic outcomes through optimal rates of demand-side participation (DSP) in the National Energy Market (NEM). As the only environmental protection organization which campaigns full time on DSP in the NEM, we look forward to providing advice to the AEMC throughout the review.

In contrast to when TEC first began its campaign, the arguments for a significant change in perspective of the NEM are now overwhelming: retail electricity prices have increased exponentially and the market's economic efficiency is under serious question as billions of dollars are spent to provide for peak demand that occurs for a few hours a year.

The NEM has reached a critical point in its history. Reform of its rules and regulations will help it reapply for its social licence to operate. But if it is to truly operate in 'the long-term interests of consumers' the Strategic Priorities market review should examine and redefine what those interests really are.

The AEMC has stated in the Discussion Paper that "[w]hat really matters for market design and the continuing delivery of affordable, reliable and secure energy for the whole community". However, these goals proscribed, rather derived from analysis of what electricity consumers themselves really believe are their long-term interests.

**Energy market objectives**

The Discussion Paper states the AEMC performs its duties "within the context of an objective that can be broadly summarised as promoting the economic efficiency of energy markets over the long term". This is essentially a broad summary of the National Electricity Objective (NEO), which is:

To promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to —

a. price, quality, safety, reliability, and security of supply of electricity; and
b. the reliability, safety and security of the national electricity system.

The purpose of adopting this single objective in the place of the previous disparate lists of objectives was that decision makers (such as regulators) were often confronted with contradictory objectives without a framework for reconciling them or according each objective with an appropriate weighting. The consequence for industry and other interested parties was that it was difficult to predict decision making and difficult to hold regulators to account where such industry or other interested party considered there to have been an incorrect judgement exercised by the decision maker.

There are a variety of overlapping reasons which appear to result in social and environmental policies not being included within the National Electricity Market regulatory framework. First, not all industry participants and not all existing National Electricity Market institutions recognise that the NEM objective is sufficiently broad to include social and environmental policy aims. Most of these parties are in fact supportive of the need for social and environmental policies but consider that those policy aims can be separated from the other policy aims that they see as falling squarely within the NEM regulatory framework. Often the assumption is that social and environmental policies are addressed in regulations outside the NEM framework such as a price on carbon, renewable energy targets, energy ombudsman schemes, and State and Territory direct assistance schemes.

But the reality is that the above assumptions are often largely misplaced. Research by the Garnaut Review, for instance, has shown that multiple market failures within the NEM will be not addressed by a price on carbon.[1]

Second, without incorporation of social and environmental objectives in the NEM, industry participants and institutions may struggle with reconciling the internal objective of pursuing economic efficiency, and wider government initiatives to mitigate and adapt to climate change and improve social outcomes. They may struggle to resolve conflicts between the immediate commercial benefits to participants and less immediate or less tangible social or environmental impacts. In other words, there can be perceived complications in weighing up between long run effects and short run effects of policies or where some effects can be easily quantified and monetized and others are best described in qualitative terms.

The synthesis of the previous multiple objectives into the single objective of the NEO was facilitated by the fact that all the previous objectives were workings of, and fell squarely within, a traditional economic rationalist framework of analysis — the result of a wider reform agenda of economic rationalism which has been part of Australian state and federal governments since the late 1970s.

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[1] Chin, Lionel, et al. (2008) *Final Report to Garnaut Climate Change Review: NEM Market Failures and Governance Barriers for New Technologies*, McLennan Magasanik Associates, Melbourne. Available at: http://www.garnautreview.org.au/CA25734E0016A131/WebObj/NationalElectricityMarketFailuresandGovernanceBarriersforNewTechnologies/$File/National%20Electricity%20Market%20Failures%20and%20Governance%20Barriers%20for%20New%20Technologies.pdf

Now in 2011, another reform process is taking place in the context of widespread environmental degradation and impending anthropogenic climate change. Businesses are actively pursuing 'green' practices, and most significantly, climate change and sustainability have become mainstream political issues. Federal and state governments are formulating policy to increase the sustainability of not only their own operations, but those in wider society as well.

If we are to transition "from supplying gas and electricity as commodities to providing a broader range of energy services" we need to examine the objectives and ethics of the National Energy Market. Its operations will need to align with what really represents the long-term social, economic and environmental interests of consumers of electricity, as well as those of Australian citizens.

**Peak demand, rising prices, investment requirements and the value of flexible demand**

TEC has repeatedly warned of how rising peak demand can lead to excessive costs of distribution because of supply-side bias in the NEM, and recently, groups such as the Australian Industry Group,[2] and the Clean Energy Council[3] have confirmed that rising costs of distribution are the most significant factor behind the recent rise in the cost of electricity.

It is therefore encouraging that the Discussion Paper names rising peak demand, rising retail electricity prices, and investment requirements as the key emerging challenges for the NEM. But while the Discussion Paper does state that "more investment has been required to meet peak demand growth", it fails to highlight distribution costs as the primary cause of rising retail prices.

Moreover, TEC is concerned about how this link between rising peak demand growth, network augmentation and demand-side participation are dealt with in the Discussion Paper.

The Discussion Paper outlines how demand-side participation can limit price rises and improve environmental outputs: "[h]arnessing the potential of cost effective demand side response along with measures to address energy efficiency can help limit increased in prices for consumers, and will also help to address governments' environmental policy goals."

However, it repeatedly presents supply-side options as the inevitable consequence of rising peak demand:

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[2] Australian Energy Group (2011) *Energy shock: confronting higher prices*, The Australian Industry Group, Sydney. Available at: http://www.aigroup.com.au/portal/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/LIVE_CONTENT/Publications/Reports/2011/Energy_shock_confronting_higher_prices.pdf

[3] Clean Energy Council (2011) *Impact of renewable energy and carbon pricing policies on retail electricity prices*, ROAM consulting, Sydney. Available at: http://www.cleanenergycouncil.org.au/dms/cec/reports/2011/Report-CEC00005-to-Clean-Energy-Council---2011-02-28a/Report%20CEC00005%20to%20Clean%20Energy%20Council%20-%202011-03-11a.pdf

"This growth in peak demand will feed through into the need for more investment in generation and expanded network capacity…"

"Our first priority recognises the need for unprecedented investment in generation capacity over the next decade to maintain reliability and security of supply, to meet rising peak demand, to respond efficiently to government climate change policies and enhance competition."

By stating that 'unprecedented investment' in supply-side options will be required to meet future peak demand, the AEMC is favouring one type of peak demand solution over another and reinforcing the supply-side bias that plagues the market. Both the AEMC and the MCE have expressed intention to give equal treatment to both the supply-side and demand-side so as to improve economic efficiency within the NEM. If they are to do so, future discussion in the Strategic Priorities review must actively work to alleviate this bias and present both demand-side and supply-side options as possible solutions.